U.S. Department of Labor

Office of Administrative Law Judges
211 Main Street - Suite 600
San Francisco, California 94105

CASE NO. 87-JTP-27

In the Matter of

STATE OF NEW MEXICO,
Complainant,

v.

UNITED STATES DEPARTMENT OF LABOR GRANT OFFICER,
Respondent

Constance Reischman, Esq.
New Mexico Department of Labor
P.O. Box 1928
Albuquerque, NM 87103
For the Complainant

Robert J. Lesnick, Esq.
U.S. Department of Labor
200 Constitution Ave., N.W.
Suite N-2101
Washington, D.C. 20210
For the Respondent

BEFORE R.S. HEYER, Administrative Law Judge

DECISION AND ORDER

PROCEDURAL STATUS AND ISSUES

This proceeding arises under the Job Training Partnership Act, 29 U.S.C. §§1501 et seq., as implemented by regulations set forth in 20 C.F.R. Parts 626 et seq., on the complainant's request for hearing appealing from the July 74, 1987 final determination issued by a grant officer of the Employment and Training Administration in the United States Department of Labor, "disallowing" $600,000 previously granted to the state under Title IIA of the Act cited above.

Proceedings here are de novo, requiring independent findings and conclusions based on the entire record received in the course of trial, both oral and written, and including a considerable body of documents submitted after the oral proceedings and in accordance with authorization to do so. The fundamental issues in this case are:

1. Whether the conduct of the state, in the situation to which the complaint refers, violated the conditions of the grant under the Act;

2. If so, to what extent and

3. What is the proper remedy.

Trial occurred in Albuquerque, New Mexico, on May 3, 1989. In addition to oral testimony and several packets of exhibits received at the oral proceedings, several boxes of additional exhibits were submitted later. A deposition was received on September 15. Both parties have submitted briefs. The later of these was received on September 21, 1989. The case is now taken under submission and decided.

BACKGROUND FACTS AND CONTENTIONS

The grant officer originally granted a sum of money to the state of New Mexico to be used by the governor of that state for the purposes set forth in title IIA. of the Act cited above, as part of a national program and goal of improving employment capacities of its citizens through educational means. The Act contemplates subgrants by such primary grantees where appropriate for the same purposes. In this instance the governor made a subgrant to the University of New Mexico. The university in turn entered into an arrangement for one academic year under which it was to acquire a computer-based system for assisting in certain kinds of basic education, and to receive certain services, within a specific time. After that time expired, the agreement was modified both in length and content. The total expenditure was $600,000 for a period a little less than two years.

The grant officer concluded in his final determination that:

1. charging to the grant the costs incurred in the original arrangement required disallowance on the ground that it violated 20 C.F.R. §629.38(b); and

2. the modification perpetuated and compounded original errors in improper procurement, on the grounds that

   (a) the payments were not "necessary and reasonable for the proper and efficient administration of the grant";

   (b) the costs were not necessary, reasonable, and allocable, as required by 20 C.F.R. §629.37(a);

   (c) the costs were "budgeted 100% to training without.
      (i) [specifying] the cost components, and
      (ii) without basing payment on successful number of job placements under 20 C.F.R. §629.38(e)(2),

(d) the transaction was not reached competitively (even though the computer-assisted training system was not shown to be unique) and did not include performance criteria,

(e) the corrective action failed to produce clear goals in unambiguous terms as required by "paragraph 164(e)(2) of the Act" and 20 C.F.R. §629.43(b) and 20 C.F.R. §629.44(c)(2), and as needed for ensuring accountability, and

(f) the system for enrollment and records maintenance violated 20 C.F.R. §629.35(c) and (d).

The complainant state contends that:

1. the subgrant did result in "substantial training of JTPA [Job Training Partnership Act] Title IIA participants in accordance with the Act and terms . . . of the subgrant" [brief, page 2] (by implication, the state contends that the state "properly provided sufficient" such training [cf. brief, p.3 with pp. 19-20]);

2. The state and the subgrantee university followed proper procurement procedures; and

3. the state met its responsibilities under the Act and both the state and the university complied with all applicable law [brief pp. 3 and 19-20].

LAW

The Act in question has been incorporated into chapter 19, consisting of sections 1501-1781 of Title 29 of the United States Code. References hereinafter will therefore be confined to the codified version, both because that version is more readily available to the general public than the original chaptered statutes and because that more convenient and modern reference system has been in general use in the more progressive jurisdictions of the country for over a century.

The purpose of that chapter (the Act) is to establish programs to prepare youth and unskilled adults for entry into the labor force and to afford job training to those economically disadvantaged individuals and other individuals facing serious barriers to employment, who are in special need of such training to obtain productive employment [29 U.S.C. §1501].

The chapter is divided into three subchapters (corresponding to the "titles" of the original Act), dealing respectively with (I) job training and employment assistance, (II) training services for the disadvantaged, (III) employment and training services for dislocated workers, and (IV) programs directly administered by the federal government. The first three subchapters provide for grants to governmental organizations other than national, such as states, to accomplish the purposes of those subchapters. Subchapter II contains two parts: B, dealing with summer youth programs, and A, authorizing other youth and adult training programs. The federal grant in this case was under part A [§§1601-1605].

Under part A, the federal government allots grant funds to the states and certain possessions [§1601]. These may only be used for programs for the economically disadvantaged [§1603] as defined in §1503(8): The uses may include (among other things) remedial education and basic skills training [§1604(3)]; institutional skills training [§1604(4)]; specialized surveys not available through other labor market information sources [§1604(9)]; literacy training [§1604(14)]; and use of advanced learning technology for education, job preparation, and skills training [§1604(22)]. Funds granted or allocated to each state may be used under this part only in accordance with a state job training plan [§1603(b)(1)] developed pursuant to §1514, which authorizes subgrants (of the federal grant money to the state) to other entities which will actually administer the programs [subsection (b)(1)].

Section 1515 sets forth a procedure for adoption of the state plan, and §1516 requires establishment of performance criteria, to be measured by increased employment and earnings and reduced public support of private individuals ("welfare. dependency"). Section 1517, which evidently applies to all grant programs under the statute, provides in pertinent part:

> (a) "The primary consideration in selecting . . . organizations to deliver services within a service delivery area shall be the effectiveness of the . . . organization in delivering comparable or related services based on demonstrated performance, in terms of the likelihood of meeting performance goals, cost, quality of training, and characteristics of participants . . . . (c) Appropriate education[al] agencies in the service area shall be provided the opportunity to provide educational services, unless the administrative entity demonstrates that alternative agencies or organizations would be more effective or would have greater potential to enhance the participants' continued occupational and career growth."

A state seeking financial assistance under chapter 19, i.e., any part of the Act, must submit a two-year plan to the Secretary of Labor, describing the use of all resources provided to the state and its service delivery areas under that chapter and evaluating the experience of those programs over the preceding two years [§1531(a)(2)]. Section 1551 requires that commercially available training packages, including advanced learning technology, may be purchased for off-the-shelf prices and without requiring a breakdown of the cost components of the package if such packages are purchased competitively and include performance criteria [subsection (d)(3)], but each administrative entity is responsible for allocation of funds and the eligibility of persons enrolled in its programs and to prevent misuse of funds by subcontractors or subgrantees [subsection (i)].

Under §1574(e)(2), the Secretary of Labor, in determining whether to impose any sanction against a recipient (state or possession) for violations by a subgrantee, should decide and consider whether the recipient state has (A) established and adhered to an appropriate system for award and monitoring contracts with subgrantees which contains acceptable standards for ensuring accountability; (B) made with the grantee a written contract expressing clear goals and obligations in unambiguous terms; (C) acted with due diligence to monitor the implementation of the subgrantee contract; and (D) taken prompt and appropriate corrective action upon becoming aware of evidence of a violation of the statute or implementing regulations.

The regulations clarify that "Sections 141, 142[,] and 143 of Act [29 U.S.C. §1551-3] apply to all programs under Titles I, II, and III of the Act [subchapters I, II, and III of U.S.C. title 29]". They also require records sufficient to "establish that funds have not been used in violation of the restrictions on the use of such funds [20 C.F.R. §629.35(a)(2)] and "to develop and measure the achievement of performance standards" [ibid., subsection (d)].

To be allowable under 20 C.F.R.§629.37(a), a cost must be necessary and reasonable, be allocable to the program, not be a general expense required to carry out the overall responsibilities of the governor (i.e., of the state) or of the subrecipient (subgrantee university in this case), and be consistent with charges normally allowed where federal funds are not involved.

Section 629.38 of 20 C.F.R., another regulation, further requires that costs be segregated into allocations for training, administration, and participant support [subsection (a)] "to the extent that benefits are received by such category" [subsection (b)], except that costs billed as a single unit charge may be charged entirely to training without segregation "when the agreement:

> "(i) Is for training;
> "(ii) Is [for a] fixed unit price; and
> "(iii) Stipulates that full payment for the full unit price will be made only upon completion of training by participant and placement of the participant into unsubsidized employment in the occupation trained for and at not less than the wage specified in the agreement."

The governor of the recipient grantee state is responsible for oversight of all state-supported programs [20 C.F.R. §629.43(b)] and for all funds granted to the state [20 C.F.R. §629.44(d)(1)], is liable for "misexpenditure of grant funds" [20 C.F.R. §629.44(d)(2)], unless the subrecipient or subgrantee was not at fault in light of the principles set out at clauses (A) through (D) of 29 U.S.C. §1574(e)(2).

The federal government has also issued a number of "OMB circulars", which, unlike statute and regulations, do not have the force of law, but at least constitute notice to the grantee state of the interpretation which the federal grantor places on the conditions of the grants, and to that extent constitute a part of the grant if lawful and issued before the grant.

Among these, OMB Circular A-87 essentially repeats parts of the statute and regulations and interprets them expressly to make a costs not allowable if prohibited by [pertinent] state or local laws, including regulations. OMB Circular A-102 likewise directs grantees to follow applicable state and local "laws" [statutes?] and regulations [paragraph 2.b], to analyze procurements in search of economy, to share goods and services for greater economy [§8], to secure ("provide") maximum free and open competition,-to impose written procurement procedures providing certain standards for soliciting offers either by competitive bid or competitive negotiation, and to make awards in light of various factors including past performance and financial and technical resources [§10] .

The latter circular allows different procedures including small-purchase procedures, competitive sealed bids, competitive negotiation, and noncompetitive negotiation. The small-

purchase category relates to less than $10,000, and therefore does not apply here. Neither competitive bidding nor competitive negotiation are described as having occurred in this case. Noncompetitive negotiation, according to this publication, may be used when the other procedures are "infeasible", but are limited to four situations:

(1) The item is available only from a single source;
(2) Urgency precludes the delay incident to competitive procurement;
(3) The federal grantor authorizes noncompetitive negotiation;
(4) After solicitation of several sources, competition proves to be inadequate [§11].

SPECIFIC FINDINGS OF FACT ON PERTINENT ISSUES, ANALYSIS, AND APPLICATION OF THE LAW THERETO

In this case the state agreed to, and apparently did, provide $300,000 to the university for the period from September 17, 1984 to June 30, 1985 as a subgrant of funds received from the federal government under subchapter IIA of chapter 19 of 29 U.S.C. The university used that entire amount on a contract into which it entered with a private company known as Degem Corporation. The record does not indicate, reveal, or imply that any effort was made to obtain competitive offers. The original paper work relating to this arrangement was in the form of a purchase order for a computer-assisted learning system, and ultimately the private contractor did, over a period of time, deliver and install such a system.

The state contends that the original purchase-order arrangement was a legal nullity and in any case did not fully set forth the actual intent of the parties. After the term of the contract expired, the parties entered into a new agreement which was in the form of a contract to provide services. On this basis the state asserts that the arrangement was never really a simple purchase, but was always intended to provided services resulting in improved delivery of training to Job Training Partnership Act participants. The grant officer through the solicitor contends that the later agreement was a subterfuge to cover up the real objective of the agreement, a simple purchase of a computer system for the state.

The new agreement extended the term of performance through two additional academic years at identical prices. The second year was completed and payment was made for that year. The third year was canceled, evidently because of investigations initiated originally by the state, but ultimately leading to this proceeding.

Despite the change in documentation between the two academic years involved (September 1984 to June 1986), both the contentions of both parties and the actual evidence indicate that the intent and actual performance during both years was essentially identical, except for the difference cause by the time taken to get the private contractor's performance fully in motion. The charge for each year was $300,000. The private contractor was to, and ultimately did, install several systems for assisting instruction, including both mobile units and stationary sites. The stationary sites and the sites at which the mobile units were used were existing educational institutions, whose personnel were already in place and employed by various entities outside the scope of the contracts in question here. The university was to become the owner of these systems. Despite early termination of the agreement, two such systems were ultimately

purchased for $180,000 each, apparently from other funds provided from sources other than the grant.

Each system consisted of a central computer unit for the instructor's use at each site, a number of satellite computer terminals for direct use of the program participants, and certain computer programs deigned to drill and test the participants in various subjects such as arithmetic, electrical theory, and other skills considered basic to enhanced employability by the state.

In the current jargon of electronic information handling, the program is known as software, the machines as hardware. A "terminal" is a machine including (among other things) a display screen and typing keyboard to permit communication with a human being. Although a witness testified that the central computer in each system was a "main frame", or on closer examination a "minicomputer or small main frame", it is reasonably inferable from the use to which the systems were to be put and the manufacturer of the machines (Digital Equipment Company, known world-wide as a minicomputer maker), and clear beyond question from the amounts of money involved, that these systems could not have included what is normally called a "main frame". In this time of heavy usage of such equipment, official notice may be taken of facts generally known in this jurisdiction, that a single main frame computer in the years involved would typically cost around a million dollars. A collection of several such systems, as here described, would have to have cost an order of magnitude more to include mainframes.

Under the contract, the private contractor acquired the basic equipment from the manufacturer, perhaps made some minor adaptative modifications, installed the software, which was experimental, installed the systems, and gave instruction to state and local people to enable them to use the equipment. The equipment was then used in existing classes to assist in the teaching of the various pertinent skills, in making records of the progress of the students, and in some statistical calculations based on that progress.

Neither the agreement nor the actual performance under it made any tie or relationship among the success of the participants, the remuneration received or to be received by the private company, nor the number of participants served. The private company did not provide any training directly to the participants. No participants were specifically enrolled in a separate course or program specifically for the purpose of using these systems.

At the time, apparently no record was assembled of the effect of using these systems for participants, although later studies were presented to show that the progress of the students were enhanced significantly by the use of these systems. The state argues that the resulting statistics show that these systems were a cost-effective way of enhancing training because their costs per student compared favorably with costs of other programs. This argument is not persuasive, because the figures are not comparable. The other programs were complete programs with teacher, classroom, the usual materials and supplies, etc. For the systems at issue here, those same other expenditures also were incurred, and the numbers shown in the study only show the additional costs added to the basic classroom program by use of the computer-aided instruction systems.

The use of the systems was not limited to participants meant to be aided by the government grant, nor were such participants given preference in the use of such equipment, nor was such equipment limited to courses in which only grant participants were enrolled. Instead, the participants were enrolled in courses along with persons who were not eligible to be, or were not registered as, participants under the statute. The systems obtained from the contractor were available for use by participants under the statutory program, by other classmates who were not such participants, and even by the general public.

In itself, the sharing of use is not necessarily objectionable. Most efficient use of expensive equipment may well often require sharing it among various persons who can benefit from it. The university argued that the university obtained some funding from other sources and therefore could appropriately share. The record does not establish, however, any particular money obtained from any other source than the grant in the acquisition of these systems during the period involved. The only other money shown to have been contributed apparently was a university expenditure of $360,000 to buy two system after the period involved. The salaries of the teachers who actually instructed and the administrators who administered the programs came from other sources, but, to the extent that Job Training Partnership Act participants were being trained, those expenses were already paid by other government grants.

Neither the state nor its subgrantee the university imposed any charge to non-participants, or made any state contribution toward the private contract of state money proportionate to the usage by non-participants. Under these circumstances, therefore, the state attempted to burden the federal grant funds intended for a special needy class with the total cost of something obtained and used for anyone in the state who could benefit from them. Making these systems available may well have served a legitimate state public benefit, but the state's failure to apportion the cost of the venture between funds intended for a narrower purpose and other funds constituted a misuse of the grant funds. Auditors selected by the state itself first detected this fault, and nothing that has happened since that time has corrected it. The state still has not contributed its fair share, nor refunded such amount to the federal granting authority, nor even made any effort to determine the extent of use of the various categories of users.

If the information had been provided in this record, and if no other deficiencies had been detected, this tribunal then might appropriately make such apportionment itself, and only require disallowance of the appropriate portion of the expenditure represented by usage by non-participants in proportion to the usage by participants. The parties have however pointed out no information in the present record which would permit such an independent apportionment by this tribunal. It was the duty of the state to acquire, utilize, and make available such information and to make such apportionment. In light of its failure to do so, this tribunal is unable to do so. The funds must therefore be found misapplied in their entirety.

Thus, the full amount of the grant must be disallowed because of misapplication of the grant under 20 C.F.R. §§629.37(a), in that the cost was not properly allocable to the program, but rather constituted a general expense required to carry out the overall responsiblities of the governor (i.e., of the state) or of the subrecipient (subgrantee university in this case).

The action of the state also violated regulation section 629.38(b) in that the agreement did not, under clause (iii), stipulate "that full payment for the full unit price will be made only upon completion of training by participant and placement of the participant into unsubsidized employment in the occupation trained for and at not less than the wage specified in the agreement." As mentioned above, the agreement did not make any provision or limitation for establishing a standard of accomplishment or measuring participants for their attainment of that standard, nor for tying the remuneration to attainment of any such standard, or the legally mandated standard of achievement of employment, or to any other measure of value or success.

In addition, it is clear that no competition occurred or was allowed. No plausible reason for failure to allow competition has been offered. The cost of the system may or may not have been appropriate, but no analysis of comparable costs has been shown, no unique aspect of this program has been shown, no emergency has been mentioned, and no other basis recognized by statute, regulation, or circular has been established to excuse the failure to use more customary methods of procurement calculated to assure full value for the expenditure. Thus the procedure followed clearly violates the standards outlined in OME. Circular A-102, since the procurement clearly exceeded $10,000. This circular constituted a reasonable statement of normal, responsible, procurement practices.

Too fine a line ought not to be drawn between a procurement of property and a contract for services. The contract in question included some aspects of both, as is not unusual. If the arrangement could reasonably be construed as either, to accomplish the goals of the program, that would be sufficient. Unfortunately, in this case, the procedures were unacceptable under either approach. If it was for services, the success of the services had to be the basis of payment under federal law. In this case, such was not the basis. If the arrangement was for a purchase, it should have followed sound government procurement procedures, assuring competition and value. In this case, that did not occur either. It appears that the possibility that the private contractor might establish a local factory distracted the state from applying the proper attention to the question of value for money, and fairness to.competitors as well as taxpayers. Here, too, then, a violation appears which goes to the chargeability of the whole grant.

The argument that state law permits the state to depend on the university as a sole source without competition on the ground that the university was also a state agency is unconvincing. The grant officer's argument that the university did not acquire the systems until after the agreement is pertinent but in itself not controlling. The precise timing of the transactions is less important than the substance, although it throws some light on the believable nature of the arrangement.

The real point is that, regardless of whether the state acted directly or indirectly, and regardless of how many levels of subgranting occurred, the ultimate arrangement with a private party did not accord with sound practice calculated to assure proper value received for funds expended in accord with federal standards.

Indeed, the practice did not even accord with state standards applicable to non-federal funds, which is also a requirement under federal law pointed out above. The regulations of the university itself required a review of all computer acquisition by a component of the university

administration. That review did not occur in this case. If such review had occurred, a more knowledgeable and competitive procedure might have evolved. In any event, whether that supposition is correct or not, that violation in itself constitutes a violation of the obligations of the state under a federal grant.

Without proceeding further, it is patent from these several violations that the expenditure must be disallowed in its entirety.

The state did not originally make a contract expressing clear goals and obligations in unambiguous terms, did not act with due diligence to monitor the implementation of the subgrantee contract, or take prompt and appropriate action to correct the situation, make or attempt a more reasonable allocation of the proper JTPA portion of the benefit of the program relative to other beneficiaries, make or attempt any comparative cost analysis to determine whether the funds spend were proper in amount, make or attempt any measurement of the success of the program in accomplishing employment, return any part of the misspent funds, obtain other services for overspent disproportionate funds, or otherwise accomplish any correction of situation.

The state is therefore not entitled to the relief sought.

DECISION

Under 20 U.S.C. §629.57, the request of the state is accordingly denied. The final determination of the ant officer is affirmed.

R.S. HEYER
Administrative Law Judge

Dated: NOV 14 1989
San Francisco, CA

RSH:wtd